
City of Los Altos
Management's Discussion and Analysis
Fiscal Year Ended June 30, 2012

The purpose of this discussion and analysis is to provide an overview of the City's financial performance and activities for the fiscal year ended June 30, 2012. We encourage readers of this report to consider this information in conjunction with the executive summary we have furnished in our letter of transmittal that can be found on pages i to viii of this report.

FINANCIAL HIGHLIGHTS

The City ended its fiscal year on a government-wide basis with total revenues of \$41 million, an 11% increase from the prior year, and operational expenses of \$34.8 million, a decrease of 2%. Operations resulted in a combined, government and business operations, increase in net assets including sizable infrastructure maintenance costs. Favorable fiscal results have again strengthen general reserves, remained within budget limits and are sufficient to sustain capital project plans.

Operational revenue gains were noted in recreation programming and general taxes including, property, sales, utility users, hotel occupancy, business license and real estate transfer taxes. Community development fees came in above projections while approximating last year's robust levels. Revenue declines were noted in the areas of franchise fees, interest income and motor vehicle license fees. Business revenues were down for the second year attributable to the impact of increased water conservation on sewer fee proceeds and the change in the solid waste disposal and recycling model.

Government-wide expenses decreased by 2% as a derivative of a moderate 1% decrease in governmental expenditures and a more substantial 9% drop in business expenses. Budget spending limits were achieved across the board with a continued focus on cost control. Over the years the City has, and continues to, mitigate cost pressures in a variety of ways including; moving forward on the further pay-down of CalPERS pension side-fund liabilities; strategically managing staffing vacancies; keeping a close eye on capital project management; the development of second-tier pension benefit plans and strict observance of budget target levels. The level of resource use reflects a concentrated emphasis on public safety, infrastructure maintenance, quality of life and community development activity.

Much progress has again been made on completing or furthering capital improvement projects, including street maintenance and resurfacing, first street streetscape and intersection improvements, citywide concrete and sidewalk repairs, pedestrian and traffic safety enhancements, bicycle transportation and parks master plan updates, street restriping and safety technology upgrades. The City made significant capital investments in the maintenance and improvement of the citywide sewer systems while progress has been made on the sewer master plan anticipated for delivery and completion in the coming months.

The City finished the year with a General Fund operating surplus, a testament to prudent budgeting, long-range forecasting and cost conscious stewardship. Although projected, the margin of revenues over expenditures came in well below prior year results and falls under pre-recession peak period levels. Budget estimates have been met for all operating and business funds yet staff remains ever diligent on containing costs, developing revenue and proactively managing reserves.

Government-Wide View

- Net assets (excess of assets over liabilities) equaled \$100 million, an increase of \$5 million, or 5%. These assets represent the City's total net holdings and are not necessarily unrestricted depending upon the source of the original funding.
- Unrestricted assets equal \$42.2 million, an increase of \$1.1 million, or 3%. Governmental unrestricted assets increased by \$1.2 million, or 4%, while business activities decreased by \$100,000, or 1%. This trend is attributed to significant grant and capital contributions with partial offsets given the use of funds for infrastructure maintenance and improvements. It is important to note that unrestricted net assets, as presented in the government-wide section of the CAFR, do not account for local fund restrictions, project assignments and/or policy reserves as classified within the governmental fund section of the report.
- Governmental activities reported ending net assets of \$87.1 million, an increase of \$4.6 million, or 6%. The increase in government arises from positive operating results, significant development fee collections, stable revenues and cost containment. These results also reflect the substantial use of resources, nearly \$750,000, for infrastructure maintenance beyond capitalized costs.
- Business activities reported ending net assets of \$13.5 million, an increase of \$700,000 or 5% due to positive operating results in the Sewer and Solid Waste Funds with partial offsets of Storm Drain activity losses.
- On a combined basis, restricted net assets amounted to \$3.9 million representing the extent to which funds are formally and categorically constrained.

Fund Level View

- The General Fund realized an operating surplus of \$1.4 million.
- General Fund revenues, excluding transfers, increased modestly by \$258,000 or 1% to \$28.9 million. Related expenditures increased by \$1.1 million to \$27.5 million, or 4%.
- The City made an additional CalPERS side fund pre-payment of \$850,000 to further mitigate pension costs pressures. This payment, combined with those made over the recent years, allows for the realization of full pay-off within the next fiscal year.
- Total governmental fund balances were \$35.5 million at fiscal year-end, an increase of \$1.2 million, or 3.5%, mainly due to the inflow of significant development grants and contributions and favorable operational results. Significant outflows were both expected and realized in the capital improvement funds.

- General government capital spending approximated \$5.1 million, a decrease of \$1.2 million, or 20%. This level of capital reinvestment reflects a continued focus on the maintenance of streets, facilities, traffic calming efforts and safety. Consequently, the Capital Projects Fund balance decreased by \$2.8 million net of incoming grant and special purpose revenues to end the year at \$6.4 million.
- The Real Property Proceeds Fund balance increased by \$143,089 and received an additional \$100,000 deposit on the sale of property at 400 Main increasing this fund's balance to \$6.9 million.
- The balance in the Community Facilities Renewal Fund increased substantially given \$3.4 million in development fees collected from the Packard Foundation as a condition of occupancy. At year end this fund balance approximated \$7.1 million.
- The Equipment Replacement Fund balance decreased to \$3.7 million with the use of funds for replacement purchases.
- Sewer operations ended the year favorably with an increase in net assets of \$182,581. Sewer revenues of \$4.5 million were \$300,000, or 7%, lower given a shift in water usage trends. This marks the third year of noted movement towards consumer conservation. Consequently, expenses also fell moderately below last year levels at \$4.4 million, or a 3% decrease. A review of maintenance expenses reflects continued attention to system maintenance.
- As forecast, the Storm Drain Fund has exhausted its available resources. This fund's reserve balances have been depleted and is now fully General Fund subsidized and will be so henceforth absent the advance of a fee-based model.
- Internal Service Funds, those that support shared costs, performed as expected. Workers' compensation claims have decreased in contrast to the prior year's adjustment for actuarial valuation. The Workers' Compensation Fund ended the year with an unrestricted fund balance of \$300,555, an improvement of \$168,046, while the General Liability fund remained relatively level at \$517,773.
- Other Non-major Governmental Funds ended the year with a total combined fund balance of \$3.9 million, an increase of \$1.1 million, or 40%, over the prior year with gains coming primarily from Gas Tax and Park-In-Lieu revenue streams.

USING THIS ANNUAL REPORT

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the City's basic financial statements, which is comprised of three components: 1) government-wide financial statements, 2) fund financial statements and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

Reporting on the City as a Whole

Government-Wide Financial Statements: The *government-wide financial statements* are designed to provide readers with a broad overview of the City's finances in a manner similar to a private-sector business.

The *statement of net assets* presents information on all of the City's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City is improving or deteriorating.

The *statement of activities* presents how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

Both of the government-wide financial statements distinguish functions of the City that are principally supported by taxes and intergovernmental revenues (*governmental activities*) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (*business-type activities*). The governmental activities of the City include general government, public safety, maintenance and public works services, planning, building, engineering and recreation. The City's business-type activities include water, wastewater, storm water and parking.

The government-wide financial statements can be found on pages 21 to 23 of this report.

Reporting on the City's Most Significant Funds

Fund Financial Statements: A *fund* is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City can be divided into three categories: governmental funds, proprietary funds and fiduciary funds.

Governmental Funds: *Governmental funds* are used to account for essentially the same functions reported as *governmental activities* in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and governmental fund statement of revenues, expenditures and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The City maintains twenty four individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the General Fund, Capital Project Fund, Equipment Replacement Fund, Real Property Proceeds Fund and the Community Facilities Renewal Fund, all of which are considered to be major funds. Data from the other nineteen governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these *non-major* governmental funds is provided in the form of *combining statements* elsewhere in the fund financial statements section of this report.

An annual appropriated budget is adopted each year for each governmental fund. A budgetary comparison statement has been provided for several key governmental funds to demonstrate compliance with this budget.

The basic governmental fund financial statements can be found on pages 26 to 32 of this report.

Proprietary Funds: The City maintains two types of *proprietary funds*. Services for which the City charges customers a fee are generally reported in the City's *enterprise funds*. These proprietary funds, like the government-wide statements, provide both long-term and short-term financial information. *Internal service funds* are an accounting device used to accumulate and allocate costs internally among the City's various functions. The City uses internal service funds to account for its City dental plan, unemployment insurance, Workers' Compensation and Liability Insurance costs. Because these services predominantly benefit the governmental function, they have been included in the government-wide financial statements and related intra-fund charges have been eliminated accordingly.

Proprietary fund financial statements provide the same type of information as the government-wide financial statements, only in more detail. All four internal service funds are combined into a single, aggregated presentation in the proprietary fund financial statements. Individual fund data for the internal service funds is provided in the form of combining statements elsewhere in this report. The City's three enterprise funds (Sewer, Solid Waste and Storm Drain) are considered major funds and presented as such in the fund financial statements. The City follows the practice of adopting annual budgets for these operations as well.

The combining statements referred to earlier in connection with non-major governmental funds, proprietary and internal service funds are presented immediately following the notes to the financial statements. Combining and individual fund statements and schedules can be found on pages 78 to 98 of this report.

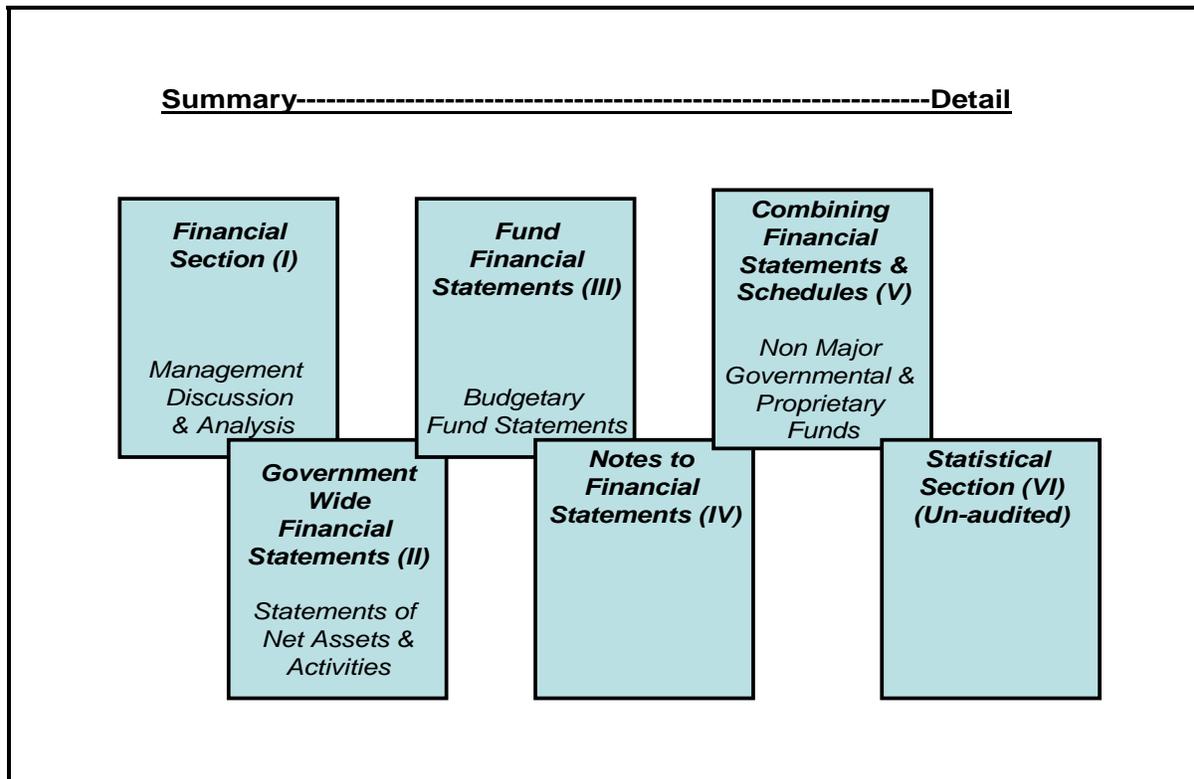
Notes to the Basic Financial Statements: The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. These can be found on pages 39 to 68 of this report.

Other Information: In addition to the basic financial statements and accompanying notes, this report also presents certain *required supplementary information* concerning the City's budget-to-actual financial comparisons for the General Fund. The City has elected to present this information within the basic financial statement and financial statement sections of the report.

The City as Trustee

Fiduciary Funds: The City is the trustee, or fiduciary, for the North County Library Authority and three special assessment districts - Raymundo and Avalon curb and gutter improvements, and Blue Oak Sewer Lane improvements. Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are not reflected in the government-wide financial statements because the resources of those funds are not available to support the City's own programs. The City is responsible for ensuring that the assets reported in these funds are used for their intended purposes.

In summary the various sections of this financial report are arranged as follows:



GOVERNMENT-WIDE FINANCIAL ANALYSIS

This analysis focuses on the net assets and changes in net assets at the city-wide level as presented in the statement of net assets and statement of activities which are summarized below as of June 30, 2012. As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. On a combined basis, the City experienced a \$5.2 million, or a 5.5% increase in net assets. An analysis follows.

City of Los Altos Net Assets

	Governmental Activities		Business-Type Activities	
	2012	2011	2012	2011
Cash and Investments	\$ 40,710,097	\$ 39,392,632	\$ 7,546,024	\$ 8,077,753
Other Assets	5,428,628	5,071,863	528,091	384,147
Capital Assets	50,270,889	47,955,812	5,951,698	5,197,408
Total Assets	96,409,614	92,420,307	14,025,813	13,659,308
Bond Debt	1,855,000	1,945,000	-	-
Other Liabilities	7,483,460	7,959,017	534,830	837,297
Total Liabilities	9,338,460	9,904,017	534,830	837,297
Net Assets				
Investments in Capital - Net of Related Debt	50,270,889	46,010,812	5,951,698	5,197,408
Restricted	3,925,741	3,061,580	-	-
Unrestricted	32,874,524	33,443,898	7,539,285	7,624,603
Total Net Assets	\$ 87,071,154	\$ 82,516,290	\$ 13,490,983	\$ 12,822,011

Investment in capital assets makes up the largest portion of the City's net assets, fifty percent (50%). These asset include reflects include land, buildings, infrastructure, and machinery and equipment, less any associated outstanding debt. As these assets represent foundational infrastructure used in support of basic City services, they are generally not available for future spending.

An additional portion of the City's net assets, three percent (3%), represent resources subject to external spending restrictions. The remaining forty seven (47%) of net asset are defined as unrestricted and generally available for future capital projects and discretionary use with the caveat these funds are a composite of several governmental funds which may include assigned project commitments and assignments especially associated with active and ongoing projects.

Some key government-wide observations include the following:

- Government-wide cash and investments holdings increased by 2% a factor of an operational and the collection of substantial developments fees, in particular \$3.4 million from the Packard Foundation development. Increased operating grant income and favorable business operating results combined with overall budget compliance has also added to this outcome.

- Government-wide net assets equaled \$100 million, an increase of \$4.7 million or 5%, due to the resource flow activity noted above and the capitalization of completed projects.
- Substantial capital improvements, approximating \$4.5 million, were realized. These include pedestrian and bicycle safety enhancements, street repairs and striping, major streetscape and intersection advances, concrete maintenance, facility maintenance, and safety technology improvements.
- Business-type activities reported net assets of \$13.5 million at year end, a \$700,000, or 6%, increase. Progress on the Sewer and Storm Water Master Plans move ahead while the City continues to maintain and plan for future improvements on a pay-as-you-go basis. Although we have noted a drop in income stream, Sewer revenue covers its expenses. The Storm Drain Fund, on the other hand, was again in need of a full General Fund subsidy with the depletion of its reserves last fiscal year. Solid Waste revenues exceeded expenses in contrast to the prior year utilization of resources associated with one-time contract renewal costs.

Governmental Activities

Governmental programs, which include general public services, displayed revenue increases of \$4.1 million, or 13%, while total expenditures remained level. Including all sources and uses, governmental net assets increased by \$4.5 million, or 6%, ending the year with a total fund balance of \$87.1 million.

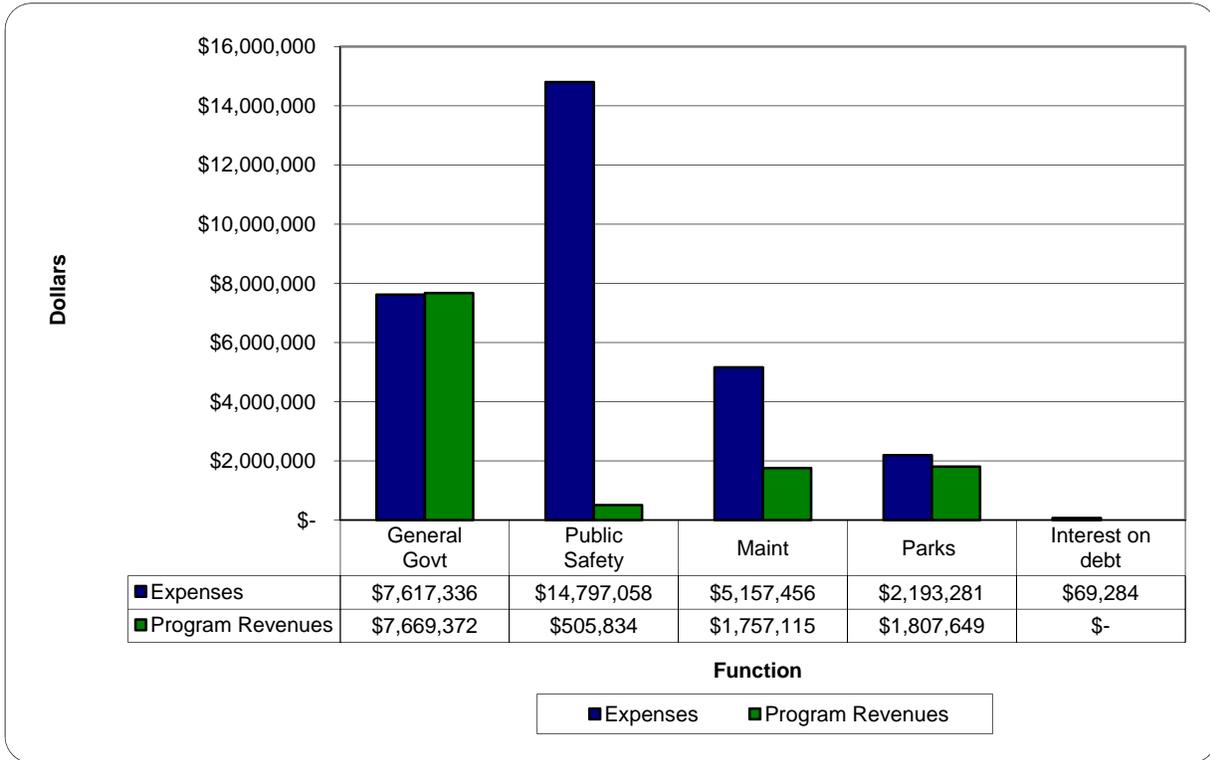
- Property tax continues to be the City's single largest source of revenue representing about 38% of general government-wide revenues. Property tax returned to its growth trend increasing by \$510,000, or 4%, a welcome change from the prior year.
- Charges for services, making up 18% of government revenues, increased by \$360,000, or 6%, from banner planning and building activity in the prior year. This revenue category was again bolstered by gains in recreation programming and marketing efforts. Both community development and recreation services continue to capitalize on their cost recovery goals.
- Other major taxes increased modestly by \$120,000, or 2%, led by a 6% increase in sales tax and a 17% increase in hotel occupancy tax. Partially offsetting decreases were noted in building development tax and motor vehicle license fee revenues pursuant to California revenue shifts in the current year.
- Interest revenues were down by \$160,000 with continued declines in interest rates. Yields remain at historic low rates in line with the current Federal Reserve posture.
- Government expenses, including allocated capital maintenance costs, increased modestly by \$195,000, or less than 1%. A closer review reveals a 5% increase in public safety expenditures, driven mostly by labor, benefits and fire service costs.
- Interest on long-term debt remained flat reflective of the City's low debt level.

A comparison of the governmental activities and business-type activities program revenues and expenses for the current year and prior year is presented below.

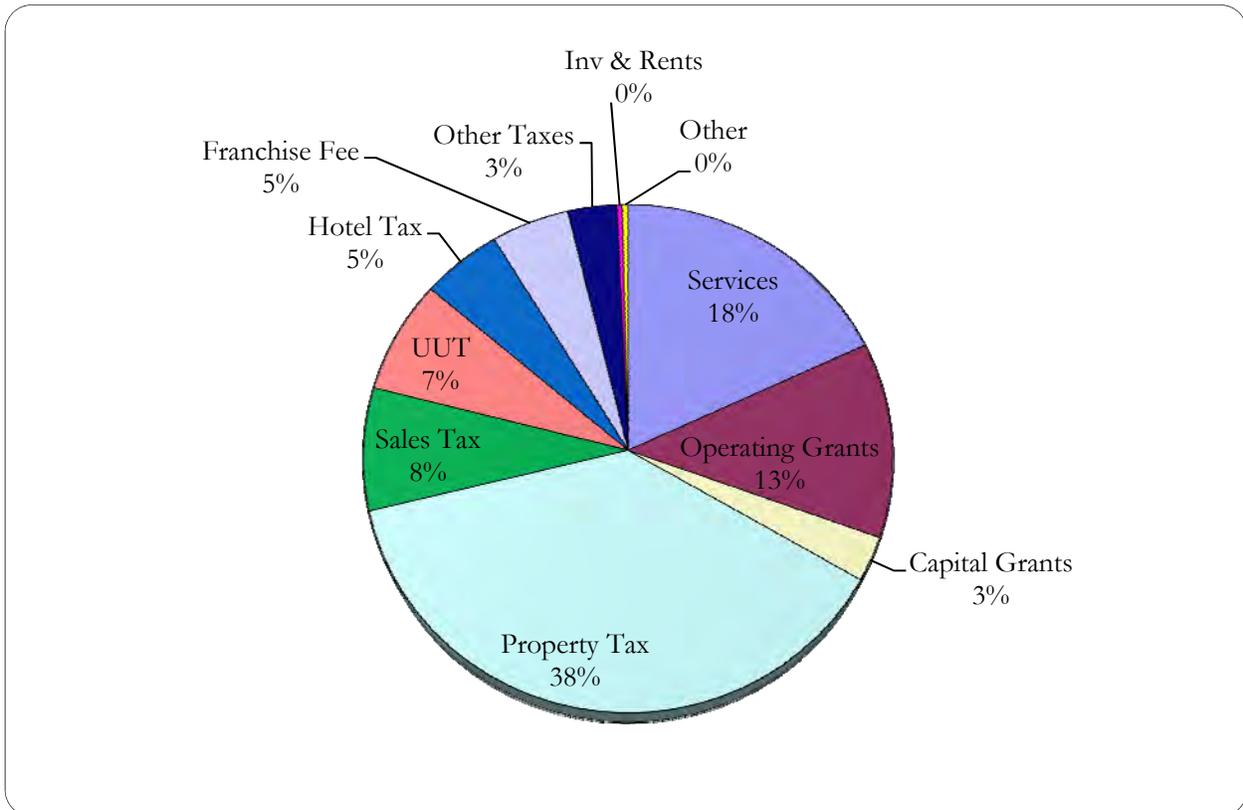
**City of Los Altos Changes in Net Assets
Fiscal Years Ending June 30, 2012 and 2011**

	Government	Government	Business	Business
	2011	2012	2011	2012
Revenues				
Program Revenue				
Charges for Services	\$ 6,012,185	\$ 6,368,897	\$ 5,804,834	\$ 5,324,514
Operating Grants and Contributions	1,014,816	998,202	-	-
Capital Grants and Contributions	788,986	4,372,871	-	-
General Revenue				
Property Tax	12,793,603	13,301,950	-	-
Sales Tax	2,587,889	2,746,374	-	-
Utility User Tax	2,543,287	2,547,777	-	-
Other Taxes	2,910,678	2,868,347	-	-
Franchise Fees	1,814,265	1,731,193	-	-
Interest Income	275,152	114,781	70,879	37,259
Sale of Capital Assets	-	-	-	-
Miscellaneous	387,716	130,833	-	-
Total Revenues	31,128,577	35,181,225	5,875,713	5,361,773
Expenses				
Public Safety	14,101,252	14,797,058	-	-
Public Works	5,450,956	5,157,456	-	-
Recreation	2,502,398	2,193,281	-	-
Community Development	4,051,892	3,583,076	-	-
Admin/Community Services	3,837,185	4,034,260	-	-
Interest on Long-Term Debt	86,452	69,284	-	-
Sewer	-	-	4,520,465	4,386,069
Solid Waste	-	-	716,599	341,449
Storm Drain	-	-	199,854	212,653
Total Expenses	30,030,135	29,834,415	5,436,918	4,940,171
Excess (Deficiency) before transfers	1,098,442	5,346,810	438,795	421,602
Transfers	(65,000)	(247,370)	65,000	247,370
Loss on Disposal of Assets		(544,576)		
Change in Net Assets	1,033,442	4,554,864	503,795	668,972
Net Assets - Beginning of Year	81,482,848	82,516,290	12,318,216	12,822,011
Net Assets - End of Year	\$ 82,516,290	\$ 87,071,154	\$ 12,822,011	\$ 13,490,983

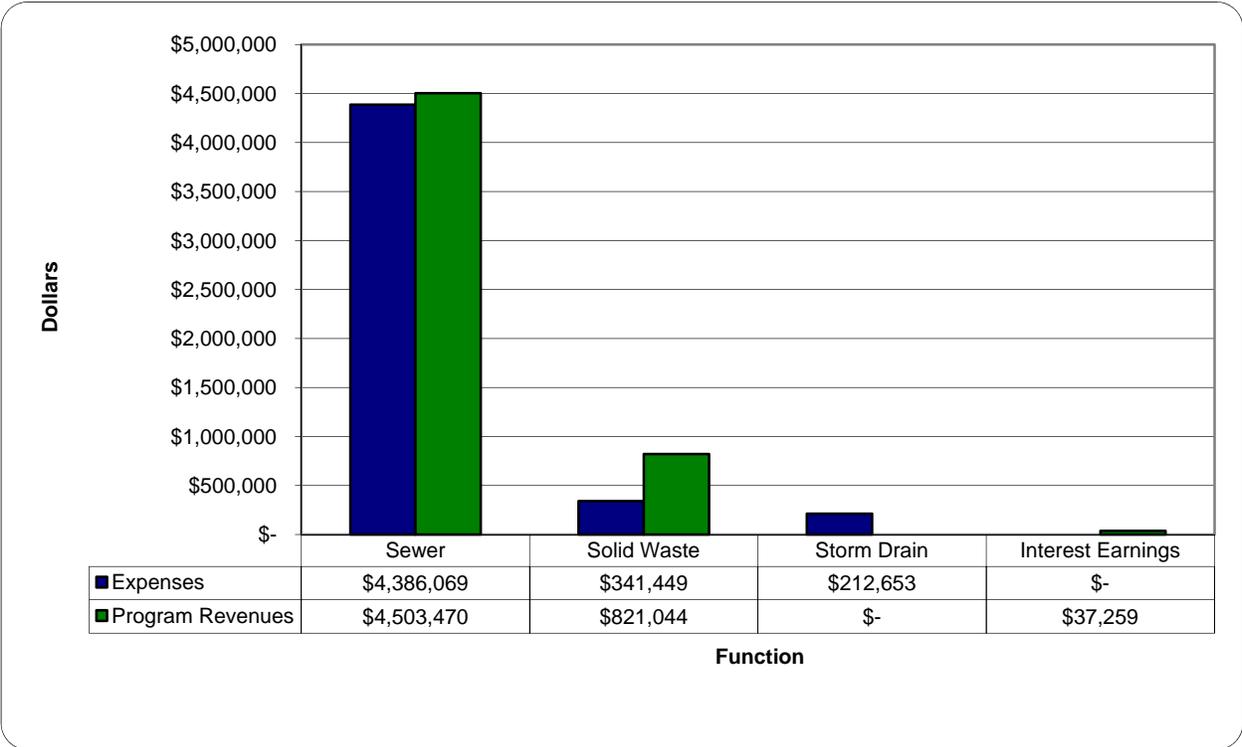
Program Expenses and Revenues - Governmental Activities



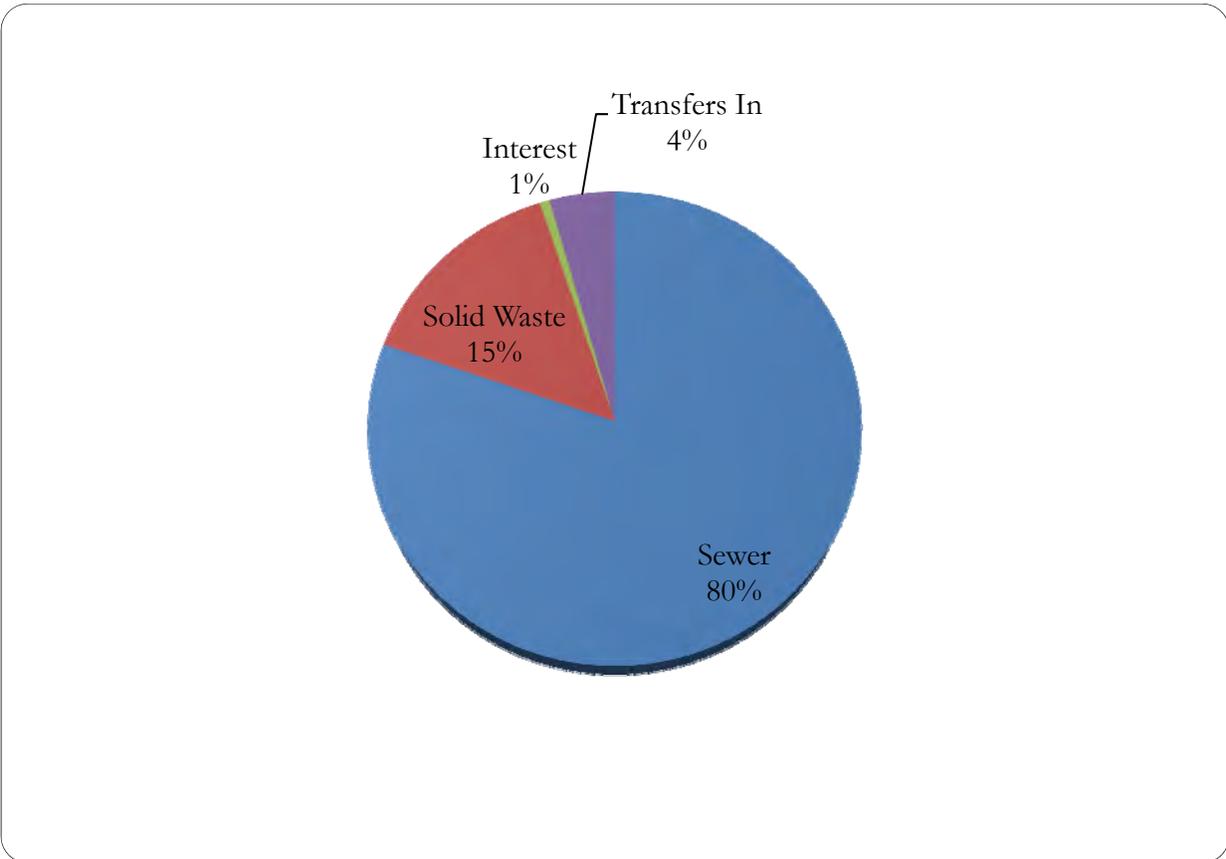
Government Revenues - All Sources



Program Expenses and Revenues - Business-Type Activities



Business Revenues - All Sources



Business-Type Activities

The programs for the business-type activities include sewer and solid waste collection management. These activities represent 13% of the total net assets. Net assets from business-type activities increased by \$668,972, or 5%, with favorable operating results augmented by Storm Drain incoming transfers.

- The Joint Sewer System Authority (JSSA) formed in 1968 by a joint exercise of powers among the Cities of Palo Alto, Mountain View and Los Altos, constructed, maintains and operates sewage treatment facilities serving its member cities. The City of Palo Alto acts as administrator for JSSA and bills each member its share of the operating costs. The City is obligated through the year 2018 under an operating agreement with the City of Palo Alto for water treatment plant and sewer services. Payments under this agreement are based on expected usage and are adjusted annually based on actual use and site operating costs.
- Sewer revenue decreased by 7% as result of conservation utility usage trends. This will be a discussion in future master plans and rate studies.
- Sewer expenditures dropped consistent with usage trends, decreasing by 3%, or \$140,000. Net assets increased by \$183,000, a slow-down from the prior year, ending the year with a total of \$12 million.
- Revenue for solid waste collections decreased by \$170,000 or 20% as result of a change in the disposal and recycling model introduced in 2010 while expenditures decreased commensurately by \$375,000 or 52% for the same reason. Accordingly, net assets for the fund increased by \$488,000 leaving a total fund balance of \$1.4 million.
- The General Fund contributed to the Storm Drain Fund to augment annual expenses. For FY2011-12 the transfer equaled \$210,555 to cover annual operational costs. As projected in budgetary estimates and the prior year financial reports, this fund has exhausted its reserves. Currently, the Storm Drain and Urban Runoff Pollution Control Programs (URPP) are categorized as Enterprise activities, but lacking a fee that pays for these services, the City may need to reevaluate Storm Drain and URPP as General Fund activities.

FUND FINANCIAL ANALYSIS

The City uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Funds: The focus of the City's governmental funds is to provide information on near-term inflows, outflows and balances of *spendable* resources. Such information is useful in assessing the City's financing requirements. In particular, unassigned or committed fund balances may serve as a useful measure of a government's net resources available for use at the end of the fiscal year. Fund balances have been re-categorized and presented in compliance with GASB 54.

The City's governmental funds reported a combined ending fund balance of \$35.5 million, an increase of \$1.2 million. Only 5% remains as unassigned and without commitment. In the past year the City has followed the practice of transferring year-end resources to the Capital Projects Fund for the maintenance and development of infrastructure. Significant capital and maintenance transfers are evident this year as the City has placed a deliberate focus on improving City infrastructure. The City also continued to fortify economic contingency reserves in anticipation of a protracted economic recovery. As the City looks ahead, we can project the need for increased services and costs necessary to maintain the current standard of living. As such, defining a dedicated source of income for infrastructure and developing short and long-term economic development initiatives, remain as critical strategic endeavors.

The City has taken the prudent path of defining and assigning establishing key fund balance reserves as called out in adopted financial policies and projected in fiscal forecasts – what some might call “rainy day funds.” These key reserves are as defined as follows:

<i>General Fund Contingency Reserves</i>	<i>June 30, 2012</i>
<i>Emergency Operating</i>	\$4,200,000
<i>State Budget Stabilization</i>	1,025,000
<i>Unreserved Fund Balance</i>	1,714,041
<i>Total General Fund Available Funds</i>	<i>\$6,939,041</i>

The emergency and operating reserves, components of the General Fund, are safeguards in the event of an economic or financial crisis. Similarly, the state budget stabilization reserve was created in response to California's delicate fiscal condition. They are certainly strategies to have in place the current financial climate.

The City has set aside \$400,000, an increase of \$200,000 over last year, for Other Post Employee Benefits (OPEB) to initiate funding of minimum post-retirement health liabilities as prescribed by CALPERS health plans. The OPEB reserve was created in response to GASB 45.

Overall favorable operating results have led to a total General Fund balance of \$7.5 million and an unassigned fund balance of \$1.7 million. These amounts align closely with long-term budgetary forecast and the adopted biennial plan.

Beyond the General Fund, surrounding and supporting funds also have key balances of importance in support of the City's fiscal plan. These are summarized as follows:

<i>Other Key Fund Balances</i>	<i>June 30, 2012</i>
<i>Ongoing Capital Projects</i>	\$4,123,943
<i>Capital Project Unreserved</i>	2,254,108
<i>Equipment Replacement</i>	3,770,575
<i>Real Property Proceeds</i>	6,910,866
<i>Community Facility Renewal</i>	7,065,592
<i>Total</i>	<i>\$24,125,084</i>

It is notable this year that the Community Facility Renewal Fund available reserves doubled with \$3.4 million in development fees resulting from the occupancy of the Packard Foundation. These dollars have been set aside for anticipated application to future capital needs.

The Capital Projects Fund balance varies materially as progress occurs on approved projects and external funding becomes available. In FY2011-12, general government capital project spending approximated \$5 million, a significant amount albeit \$1 million less than the prior year. The City continues to make progress in this area as evidenced by the following list of renovation projects expenditures noted in the preceding transmittal letter. Beyond those listed therein, the City continues to make progress on the long list of funded capital projects identified within the Capital Improvement Project Plan and tracks a tally of unfunded projects as well for future consideration.

Proprietary Funds: Proprietary funds provide the same type of information found in the government-wide financial statements, but with more detail.

Unrestricted net assets at the end of the year in the Sewer Fund decreased to \$6 million, the Storm Drain Fund balance remains dependent on the General Fund and the Solid Waste Fund increased to \$1.4 million. Factors concerning the changes in fund balance in these funds have already been addressed in the discussion of the City’s business-type activities.

Both the Sewer and Solid Waste funds receive revenues from the City as a customer for routine service operations. In FY2011-12 the City paid approximately \$18,000 in sewer fees and \$300,000 in waste hauling and disposal services. These amounts are recorded within the “Charges for Services” revenue line item in the proprietary financial statements.

Capital Assets and Debt Administration

Capital Assets: The City’s investment in capital assets for its governmental and business-type activities at year-end amounts to \$56 million (net of accumulated depreciation).

Investments in capital assets include land, buildings, improvements, machinery, streets, infrastructure and equipment. Governmental capital assets totaled \$50 million and those of business-type activities totaled \$6 million. Assets increased by \$2 million overall with the completion of several significant projects. Additional information on capital assets can be found in footnote 4 of these financial statements and a summary is listed below:

Capital Assets as of June 30, 2012

	<i>Government Activities</i>	<i>Business Activities</i>	<i>2012 Total</i>	<i>2011 Total</i>
<i>Land</i>	\$11,539,449	\$0	\$11,539,449	\$11,539,449
<i>Work in Progress</i>	4,522,348	1,047,796	5,570,144	6,810,138
<i>Buildings</i>	14,037,269	4,651,233	18,688,502	18,198,995
<i>Improvements</i>	3,733,354	0	3,733,354	1,472,263
<i>Machinery & Equip</i>	1,263,207	252,669	1,515,876	1,786,278
<i>Infrastructure</i>	15,175,262	0	15,175,262	13,346,097
<i>Total Assets</i>	\$50,270,889	\$5,951,698	\$56,222,587	\$53,153,220

Debt Administration: At the end of the current fiscal year, City bond and assessment debt decreased by approximately \$100,000. The total outstanding bond debt balance at year-end is approximately \$1.8 million and relates solely to the purchase of Rosita Park (formerly known as the Saint Williams site). No additional debt was incurred and the City has no significant capital leases.

Other debt consists of long-term employee compensated absence obligations of \$1.5 million, for general and business activities, a factor of accumulated balances at year end.

Additional information on long-term obligations can be found in footnotes 6 and 7 to these financial statements.

Long-Term Debt as of June 30, 2012

	<i>Government Activities</i>	<i>Business Activities</i>	<i>2012 Total</i>	<i>2011 Total</i>
<i>Certificate of Participation</i>	\$1,855,000	\$0	\$1,855,000	\$1,945,000
<i>Compensated Absences</i>	1,434,236	40,655	1,474,891	1,623,321
<i>Total</i>	\$3,289,236	\$40,655	\$3,329,891	\$3,568,321

The City also carries and a year-end net Post-Retirement Health obligation (OPEB) of \$793,000. This obligation increased in line with annual actuarial valuations and is a factor of benefit levels and population metrics.

GENERAL FUND BUDGETARY HIGHLIGHTS

The adopted FY2011-12 General Fund budget equaled \$28.6 million and changed modestly by \$345,000 to \$28.9 million during the year. Prior year encumbrances account for the bulk of these adjustments, leaving adjustments during the fiscal year of less than 1%. Budget to Actual results came in favorably with revenues exceeding estimates by 1% and expenditures coming in at 95% of established limits.

ECONOMIC FACTORS AND FY2011-2013 BIENNIAL BUDGET AND RATES

General Fund revenue is forecast to increase by 4% per the FY2012-13 budget while expenditures are being held to a similar level. No significant changes were made as the budget presents a continuity of a balanced equation. Several personnel positions remain frozen, although not always the same positions as in the recent past.

In full recognition of the fiscal challenges that remain, the budget was developed to maintain a sound fiscal posture, present a balanced General Fund and enhance contingency reserve levels in light of historic economic uncertainties. The budget has been crafted as a two-year, 2011-13, plan and includes a five-year strategic forecast.

- Revenues are expected to uptick slightly and the City continues building towards its operational goal of a 20% reserve as endorsed four years ago by Council. OPEB reserves as required will be added to as well as transfers proposed from the General Fund to fund Capital Projects and Equipment Replacements. In FY2012-13 the City moved to blend its Emergency Operating and State Budget Stabilization Reserves achieving a contingency reserve level of over \$5 million.
- The budget projects an increase of 5% in property tax receipts, coming off of a 4% increase in FY2011-12 and includes secured property tax, unsecured property tax, homeowner property tax relief, property tax in lieu of vehicle license fees and supplemental property tax. Property tax makes up 46% of all governmental funds revenue.
- Other key taxes are estimated to experience increases. Utilizing the most recent data and regional and national trends, sales tax revenue is projected to go up 6% while hotel occupancy tax again displays recovery with a 7% increase. Other taxes including real estate transfers, motor vehicle license fees and business license all display modest growth.
- Planning and building activity has shown strength. This trend, combined with significant planned commercial developments, has influenced a 3% projected increase in this revenue base coming off of very strong gains in the past two years.
- Franchise fees are projected to experience moderate gains now that the newly-established waste hauling contract has covered its first full fiscal year of implementation.
- No new positions were added with the number of authorized positions remaining unchanged at 130.
- The two-year budget honors existing multi-year labor contracts. Of our 130 authorized positions, seventy (70) are represented and forty-nine (49) are not represented, excluding department directors/managers. Salary levels remained within budget projections.
- General operational costs were held to a 4% increase including recently negotiated labor contracts. Materials and service expense cuts and deferrals continue and this budget also maintained several frozen positions city-wide subject to strategic and fiscal review during the budget year.
- Overall PERS pension rates increased but were mitigated by the prior year pay-down of the City's side-fund liability. This liability is expected to be fully paid down in FY2013-14. Rates for public safety and miscellaneous employees increased moderately from FY2011-12 levels but are expected to increase in the out years give assumption changes and market conditions. Health insurance rates are assumed to increase by 7.5%.
- As part of contract negotiations, the City successfully implemented a second-tier pension model that lowers the level of benefit for new hires beginning July 1, 2011. This change is anticipated to render material savings as the years evolve.
- The budget further augments the funding of OPEB through the establishment of an internal assigned reserve projected to be \$500,000 by the end of FY2012-13.

For a more current discussion of the state of the economy beyond those assumptions made in the FY2011-13, two-year, budget process, the reader should also refer to the transmittal letter included in this document.

CONTACTING THE CITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, investors and creditors with a general overview of the City's finances. Questions concerning any of the information provided in this report or request for additional financial information should be addressed to the Finance Director, One North San Antonio Road, Los Altos, CA 94022.